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## THE NORTHWEST IN THE RECENT FINANCIAL CRISIS

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The story of the panic of 1907 varies little from that of former panics. If, however, we profit by its lessons and evolve from its troubles proper financial legislation that in future will protect our banks and commercial interests against danger and loss, the panic of 1907 will not have been without compensation. As was the case in 1857, this country in 1907 was seemingly most prosperous. There was much railroad construction, involving the sinking of a great amount of capital far beyond what was immediately productive; speculation was rife, accompanied by much extravagance in both public and private life; graft and dishonest business methods were exposed; money was in increasing demand at steadily rising rates; there were many strikes and labor was dictatorial in its demands; real estate was active and there was a reckless expansion of all credit.

These conditions are the familiar forerunners of every panic; but our people paid no heed to the warnings uttered by students of finance, spoke jestingly of "a prosperity pinch," and went on in search of easy wealth until the failure of the Knickerbocker Trust Company in New York plunged the country into a senseless panic. As in 1857, the failure of the Ohio Life and Trust Company of Cincinnati; as in 1873, the failure of Jay Cooke & Co.; as in 1893, the failure of the Philadelphia and Reading Railroad Company and the National Cordage Company, so in 1907, the failure of the Knickerbocker Trust Company marked the end for some years to follow of our country's reckless financial operations.

The bankers of the Pacific Northwest were not altogether unprepared for financial trouble in the East; they had read the handwriting on the wall and were warned of approaching danger. And yet, when the storm broke, they were not prepared, for they found themselves stripped of their Eastern balances and forced to depend upon the actual coin within their vaults. Confidence, begat by the

knowledge that the Northwest was out of financial bondage to the East, that the whole world was calling for its lumber, that an immense wheat crop had just been successfully harvested, which England was eager to buy at highly remunerative prices, was destroyed in a second, and for a moment the people of the Northwest could see nothing before them but disaster.

Prior to October 28th the Pacific Northwest had watched with interest, but with no concern, "the rich man's panic in Wall Street," had noted the struggle of the Copper Kings, the failure of the Knickerbocker Trust Company and the great run on the Trust Company of America. The troubles in New York were interesting, but did not closely concern the Northwest. But on October 28th all was changed. Telegrams poured into Portland from bank correspondents all over the country, "Cannot ship you coin or currency against your balance. Make your drafts payable only through the clearing house. Advise you organize for your own protection." The financial machinery of the United States had broken down and in a flash business was paralyzed.

The Portland bankers then carried in their vaults but the usual amount of coin necessary for the ordinary transaction of business. When the shock came, October 28th, they had barely begun to shift their balances westward, an action always necessary at crop-moving time. Face to face with the problem of moving thirty millions of bushels of wheat, threatened by frightened and hysterical depositors, with no funds other than those then in their vaults, they sought aid from the governor of the state. His excellency at once grasped the situation, and on October 29th declared a legal holiday that continued, with the exception of three days, from October 29th until December 16th. On the latter date Portland returned to normal conditions, the first of all the larger cities to remove all restrictions on payments. The return was accomplished without trouble or excitement; the people had had time to cool down and the good sense and loyalty of our citizens did the rest. But though there was a legal holiday from October 29th to December 16th, the banks of the state kept open. The holiday gave protection to the banks against hysterical depositors, prevented attachments being levied on the state banks and made possible the restriction of payments.

The moment a holiday was secured the Portland banks, on October 29th, authorized the issuance of clearing-house certifi-

cates for use between the banks in settling balances. One million dollars in certificates were issued, but by December 16th six hundred and thirty thousand dollars worth had been retired. The most difficult problem to face was to finance and move the wheat crop. There was not enough coin in the banks and some sort of a circulating medium to serve as an emergency currency had to be devised and one that the people would take.

Printing-presses were set to work manufacturing what was known popularly as "Wheat Money." The banks agreed to take it on deposit or in payment of debts. This was necessary to give the scrip negotiability. This emergency currency was in denominations of \$1.00, \$2.00, \$5.00, \$10.00, and \$20.00, and in all over a million dollars were placed in circulation. In the main it was secured by wheat in warehouses, covered by insurance, and for every dollar of scrip so issued there was in the warehouses \$1.50 of wheat. Some small amount was issued also against approved bonds in the same ratio. The currency was readily taken in all the stores and by the railroads, and yet it was liked by no one. Better secured even than national bank notes, since behind national bank notes ultimately is only the tax-raising power of the United States, nevertheless Portland's wheat money, lacking the power of legal tender, drifted quickly back into the banks. Such in brief is the story of the panic from the view point of the Pacific Northwest. What of its lessons?

To him who was in the control and management of a national bank in Oregon in the fall of 1907 two dangerous faults in our existing financial laws were strikingly apparent, to-wit, the utter weakness of the fictitious system of bank reserves, and the total inadequacy of our present financial system to withstand the onslaught of unreasoning panic.

### *Fictitious Reserves*

In an address delivered before the Washington State Bankers' Association at Whatcom, July 23, 1903, the writer, in speaking of bank reserves, said as follows:

"Under the present National Bank Act, in other than reserve cities, a bank is permitted to loan all but 15 per cent of its liabilities; of this 15 per cent three fifths may be deposited in a reserve city; and the banks of a reserve city are permitted to deposit one-half

of their 25 per cent reserve in New York, Chicago or St. Louis, where the national banks are required to keep but 25 per cent in coin. Has it ever occurred to you how small an amount of coin is thus behind the deposits of the country? How dependent all the banks of the country are upon the resources of the great banks of New York, Chicago and St. Louis? The restrictions of the National Bank Act may, in the opinion of the framers of that law, be sufficient protection to the depositors, but does anyone here think it reasonably safe banking to have but a little over 6 per cent in cash behind his deposits? And yet a compliance with the National Bank Act requires but that much coin. For instance, a national bank in Whatcom has \$400,000 deposits; of its \$60,000 reserve \$36,000 may be kept in Portland; against the \$36,000 Portland must keep a reserve of \$9,000, of which \$4,500 may be in New York, and New York is required to keep but \$1,125 of this on hand. To meet the \$400,000 in Whatcom the requirements of the National Bank Act are fulfilled with only \$29,625 cash, or a trifle over 7 per cent. This may be sufficient protection to the public, but when Uncle Sam deposits his money, he requires as security dollar for dollar in his own obligations. When we note how closely the banks of the country are knit together, how dependent they are upon one another, is it a matter of wonder that a panic in Wall Street is felt throughout the length and breadth of the land? Is it wise to be so dependent? Should our banks not be more independent? And to do so should they not carry more of their reserve in their vaults?"

But these remarks only referred to national banks and their reserves. When account is taken of the scanty reserves maintained by state banks, private banks, savings banks and trust companies, the amount of actual reserve behind the deposit liability of the country dwindles to such small figures that one staggers with amazement at the vast amount of credit that rests upon a single dollar. With this thought in mind need one be surprised that a run on the Trust Company of America caused a currency famine in New York, the effects of which were felt throughout the length and breadth of the land?

In framing the National Bank Act (of which most state bank acts are but loosely-drawn imitations with more lax restrictions) the theory seems to have obtained of concentrating the actual

money of the country in the large cities. A reserve that is on deposit with another bank is not a cash reserve. The only cash reserve is coin in the vault. It is a good asset of the bank, but by no means cash. The present system of reserve on reserve, reserve on reserve, makes it more difficult to find the true reserve than it is to find the elusive pea in a shell game.

The complete breakdown of the present system of reserve was illustrated in the recent panic. Beyond permission to draw against their balances in "Clearing House Funds" the legal reserves maintained in the East by the banks of the Pacific Northwest were almost valueless as a source from which to draw funds to meet the demands of depositors. The banks were forced to depend upon the actual coin in their vaults and to manufacture such other circulating medium as the suffering public would endure. Does not this experience prove that our system of reserves is a fiction, false in theory and worthless in practice?

If banks were required to maintain in their own vaults the full legal reserve there might be contraction of credit for a time, but the financial institutions of the country would be on a sounder basis. However, there is little hope for change, especially as long as the payment of interest on daily balances exists to arouse the avarice and befog the judgment of the average banker.

### *The Weakness of our Financial System*

That a currency famine in New York should endanger every financial institution in the Union, and in a year of bountiful crops and great prosperity cause a widespread and senseless panic is sufficient evidence of the extreme weakness of our system of finance to cause every Doubting Thomas to favor currency reform at once. Writing forty years ago Robert Baxter said, "provision should be made for such a contingency as a panic, so that, when hoarding interrupts the necessary flow of currency, a new stream may, under proper safeguard, be created and the course of business sustained." The necessity for such a provision, for the issuance of some kind of an emergency currency, had ample illustration in the fall of 1907. Every great city and many smaller ones in October and November issued clearing-house certificates for use in settlements between banks, and in addition, in order to

prevent the utter stagnation of business, issued in unlimited quantities clearing-house scrip of small denominations.

Can there be a better example of what reform is needed in our financial system than the fact that throughout the length and breadth of our land local emergency currency was issued to discharge the duties of a national currency that had largely disappeared from circulation? As a supplement to the national currency this suddenly-developed circulating medium served its purpose well. Without concerted action on the part of the banks, in a night, this local emergency currency sprang into existence to perform the daily exchanges of business. The emergency that called into existence having passed, it quickly gave way to the better currency and was retired.

How much better a true emergency currency with legal tender qualities would have been, any one who handled the hundred different kinds of clearing-house scrip can bear witness. Had there been provision for an emergency currency as in France and Germany, and in a measure in England, the financial disturbance in New York would not have involved the entire country. The frightened depositors of that city would have been met with an ample supply of funds and New York's financial institutions would have paid the price, for no plan for an emergency currency should ever be adopted that does not include a steadily rising tax to be levied upon the banks taking out such currency; and the tax should be no light burden, such as three or four or even five per cent, lest in avoiding panic we are ruined by expansion.

Sumner says, "Any device which has elasticity for its object will have expansion for its effect." And expansion spells ruin for our financial system. We therefore must beware of the expansionists with their asset currency nostrums and keep ever before us that the standard of value is gold and that gold can carry but so much burden. Overload gold with too great an amount of paper promises to pay and the precious metal will leave our shores and we shall be dependent upon fiat money. Better a panic every year than gold at a premium.

How should our laws be amended to permit the issue of an emergency currency that shall be sound, be quickly issued when required, and rapidly retired when the emergency is passed? The best plan proposed is a central bank of issue, approaching as nearly

as possible to the Imperial Bank of Germany. But it is to be feared that the intelligence of the average congressman is not of high enough order to rise above fear of local prejudice and to permit him to vote for the good of the whole nation, if it does not suit his local banker. Should the unexpected happen, however, and Congress rise to the needs of the country and pass a bill for the establishment of a central bank several points must be covered:—

1. The government must have a voice, and perhaps a controlling one, in its management.
2. No one section of the country should be permitted to dominate in the directorate; all parts of the country should be represented.
3. The bank should be a bank of issue and not of deposit. Its profits should be derived from lending its circulation and its debtors should be the banks of the country.
4. To it alone should be given the power to issue an emergency currency, and care should be exercised in the amount of gold reserve.
5. The national bank currency and greenbacks should be retired.

If the central bank cannot be established and we have to work with the tools we have on hand, which is more than likely since changes come slowly, then to the national banks should be given additional powers. They should be permitted to take out an emergency currency to the extent of 50 per cent of their capital on comparatively easy terms. This currency should be a legal tender and in all forms like the present notes. It could be protected by a small tax on all the national banks as well as by deposit of securities. Above all and before all it must be taxed on a rising rate such as will make sure its retirement when the emergency passes. Panics come quickly and do not last long, so that the emergency currency should be promptly issued and as promptly retired.

The panic of 1907 has passed into history; whether its lessons will have taught us aught of good or will bring about reform in our financial system remains to be seen.